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In the

Supreme Court of the United States

October Term, 1962

THE CLIFTON INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above case on February 6, 1963.

OPINIONS BELOW

The opinion of the Tax Court of the United States is reported at 36 TC 58.

The opinion of the Court of Appeals for the Sixth Circuit is reported at 312 F 2d 719.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was made and entered on February 6, 1963 and

copy thereof is appended to this petition in the appendix at pp. 29-34.

Petition for rehearing in banc was denied by order on March 11, 1963, and copy thereof is appended to this petition in the appendix at p. 35. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

The Petitioner sold its office building, housing commercial tenants, some of whom used their premises as sleeping rooms also, to the City of Cincinnati under threat of condemnation in 1956, and reinvested the proceeds thereof in the controlling capital stock of a corporation which owned a hotel building which also had a number of commercial tenants.

The questions presented are:

1. Whether the subsequently-acquired property (hotel building) was "similar or related in service or use" to the converted property (office building), within the meaning of Section 1033 (a) (3) (A) of the Internal Revenue Code of 1954, so as to entitle the Petitioner to treat the sale under threat of condemnation and the subsequent replacement of its property as a Tax Free Involuntary Conversion.

2. Whether District Judges sitting by designation on a Circuit Court may consider and deny a petition for rehearing in banc by that Court.

STATUTES INVOLVED

The pertinent portions of Section 1033 (a) (3) (A), Internal Revenue Code of 1954 (Title 26 U.S.C. Section 1033 (a) (3) (A); and Title 28 U.S.C. Section 46 (c)) are set forth in the Appendix at pp. 35-42.

STATEMENT

The Petitioner is a corporation organized under the laws of the State of Ohio, with its office in Cincinnati, and is primarily a realty company whose business activities include purchasing and owning investment real estate held for the production of income (R. 14a).

1. CONCERNING THE INVOLUNTARY CONVERSION

On June 10, 1946, the Petitioner purchased the United Bank Building located at the southeast corner of Third and Walnut Streets in Cincinnati, and it owned this land and building until its sale to the City of Cincinnati on January 16, 1956, which sale was made and completed under the threat of exercise of the power of eminent domain by the City of Cincinnati (R. 15a).

On January 20, 1956, the Petitioner invested all the proceeds received from the sale of the United Bank Building plus additional sums, in the purchase for $200,000.00 of 80 percent of the voting stock and 80 percent of the outstanding stock of all classes of The Times Square Hotel of New York, Inc., an Ohio corporation (R. 16a).

The Times Square Hotel of New York, Inc., was incorporated in Ohio on November 2, 1955. On November 21, 1955, it had contracted to purchase the Hotel Times Square building located in New York. On January 21, 1956, in accordance with its contract, it did purchase the Hotel Times Square (R. 16a-18a). The Petitioner reported the transaction on its return for its fiscal year ended November 30, 1956, as non-taxable under Section 1033 of the Internal Revenue Code of 1954 (R. 29a).

2. COMMISSIONER'S DETERMINATION

The Commissioner of Internal Revenue determined that the "gain realized on involuntarily converted property" was taxable (R. 110a). The adjustment is explained in the deficiency notice as follows:

> "(a) It is held that you are not entitled to non-recognition of gain realized on involuntarily converted property as provided in Section 1033 of the Internal Revenue Code (1954) since that which was acquired was not similar or related in service or use to the property converted" (R. 110a).

The Petition assigned error to the Tax Court of the United States (R. 2a-12a).

3. CONDUCT OF THE BUSINESS OF PETITIONER RELATING TO RELATION OF THE PROPERTIES TO IT.

The Petitioner's chief witness in the Tax Court was its President and Treasurer and also its chief shareholder, Mr. Albert Harris (R. 46a; R. 49a; R. 53a-54a).

Mr. Harris characterized his occupation as real estate and everything connected with the business of real estate (R. 45a). He had been in the real estate business since 1919, over 40 years, was a licensed member of the Cincinnati, National and State Real Estate Boards since 1927 and had built properties and bought and sold investment properties of all sorts during his business experience (R. 45a). He as a direct owner, or as a shareholder of a corporate owner, had held an interest as an investor in virtually every type of real estate investment. His testimony includes a partial list of his investments. (R. 46a-48a)

> "Q. Have you been an owner, either as a shareholder or partner, in a company which owned an office building?

A I have; yes, sir.

Q And what office buildings did you have any interest in?

A I was part owner in the Bell Block located here in the City of Cincinnati at the northeast corner of Sixth and Vine Streets; the Schmidt Building which is located at the southwest corner of Fifth and Main Street, Cincinnati; the United Bank Building at the southeast corner of Third and Walnut Streets. I had some interest in a building at Forest and Reading Road known as the Palmer Building, and others that I just can't think of (14) at this moment.

Q Have you ever been an owner, either as a shareholder or partner or proprietor in a company which owned apartment buildings?

A I have.

Q Would you state your experience in that field?

A I have built apartment buildings and dealt in them since 1928 or '29.

Q What buildings have you been a parther or shareholder or owner in?

A I was an owner in the Sherbrooke Apartments on Chalfonte Place near Reading Road; the Waldorf Apartments at 3652 Reading Road, Cincinnati, which I built.

Q How many apartments are there in that building?

A 88 apartments in that particular unit. I built and owned the Stonybrook Apartments located at 7606 Reading Road in Roselawn, Cincinnati.

Q How many units are there in that building?

A There are about 36 apartments and janitor's quarters plus stores and other items connected therewith. I owned quite a number of apartment buildings and other types of business. One was at 451 Ludlow, Clifton.

Q How many units in that building?

A 64 apartments. And an apartment building in Middletown which had about 90 apartments. I built two apartment buildings which were ten units each, for the Clifton Investment Company in

about 1952 or '53. They were located on Reading Road in the 4000 block.

Also at that time I built six residential homes for the Clifton Investment Company during the year 1952.

Q Now have you been a shareholder, a partner or an owner in a company which owned any hotel buildings?

A I owned a hotel as far back as 1927 or '28. The first one, I believe, was at 34 East Sixth Street, a small hotel which had 45 units which I remodeled from an office building to a hotel building. The next one I believe was the Avondale Hotel which is located at Gholson and Reading Road in Cincinnati, and since then one in Lawrenceburg, Indiana, out of the state, and one in St. Louis and one in Detroit.

Q What hotels did you have in these various cities?

A In Lawrenceburg, Indiana, it was known as the King Hotel.

Q And in St. Louis?

A In St. Louis it was the DeSoto Hotel.

Q What type hotel was that?

A. The DeSoto Hotel consisted of about 300 rooms with three ballrooms and six private dining rooms, stores, offices, meeting rooms.

Q What other hotel properties have you owned?

A Another one is the Fort Wayne Hotel in Detroit, located at Temple and Cass Avenues, Detroit, Michigan. That building consists of 300 rooms and has bowling alleys, stores, meeting rooms, barber shop, beauty shop, news shop, restaurants, cocktail bars and a number of other things.

Q What other buildings?

A Mention another one?

Q Just by name.

A I can recollect one we still own that is in Columbus, Ohio, that is known as the Broad-Lincoln Hotel. It likewise has meeting rooms, cocktail bar, restaurant and a number of other things that are in there."

Mr. Harris controlled the policy of the Petitioner. He acquired the United Bank Building for the Petitioner (R. 49a), he handled its renting, its leasing and its employment (R. 51a-54a). Its books were kept in his office (R. 52a). When its property was sold under threat of condemnation he selected the replacement property (R. 59a).

During the period in issue the Petitioner, under Mr. Harris's direction, also built apartment buildings for its own investment and built family residences (R. 47a; R. 53a-54a).

4. SIMILARITIES BETWEEN THE CONVERTED AND REPLACEMENT PROPERTIES

The United Bank Building was a six-story building of masonry construction with one operating elevator, and was equipped with the usual services for heat and light. The building was used by the Petitioner to produce rental income (R. 15a). The Petitioner rented space in the United Bank Building on a month-to-month or on a lease basis (R. 16a). The tenants of the United Bank Building included a night club, restaurant and bar, artist studios, music studios, boat supply sales, air conditioning products, coffee mill sales agent, optical supply house, theatrical supplies, mercantile agent, elevator company office, photo engraver, lens grinder, surgical repair office, editorial office of magazine, textile supply, wholesale sportswear, advertising agency, sculptor's studio and law office storage. In some instances tenants used, and were permitted to use, offices and studios occupied by them as sleeping rooms (R. 30a; R. 50a; R. 52a-53a).

The Times Square Hotel building is a fifteen-story building with a partial sixteenth floor of brick, concrete and steel construction (R. 58a). It has elevators, a heating plant and lobby. The building was used by the Petitioner

to produce rental income. The rooms in the building were rented on a monthly, weekly and transient basis (R. 57a). Fifty-five tenants were New York State controlled monthly tenants (R. 57a). The building also has, as commercial tenants, a barber shop, dentist office, doctor's office, jewelry store, exporter's office, newsstand, Letter Carriers Association, public stenographer's office, theater ticket office, valet, luncheonette, luggage store, Signal Electricians Association, Printers Union and a private school (R. 32a, R. 56a).

The commercial rents in the United Bank Building in 1955 were $21,242.00 and the commercial rents of the Hotel Times Square in 1956 were $37,404.05 (R. 30a- compilation; R. 32a).

The Petitioner did not use or occupy any of the rental premises in either the converted or replacement properties.

The Petitioner's President explained the similarities between the management activities, the amount and kind of service rendered by it to tenants and the nature of the business risks connected with the properties, in the case of the converted and replacement properties. Both the converted property and the replacement property were located on corner lots in the hearts of great cities (R. 59a-60a), were sound structures and resembled one another very much (R. 59a-60a). They had vending machines, elevators, heating systems of the same type, and heat, janitor services, hot and cold water, were furnished tenants in both instances (R. 60a).

As to similarity in tenancies, both had an eating and a drinking place, meeting rooms, art shops, offices, stores, storage rooms and schools (R. 60a).

Management in both instances had the problems incident to payroll, uniforms, laundry, insurance, supplies, internal and external building maintenance, upkeep, decorating, plastering, carpenter work, payroll taxes, bookkeeping,

records, audits, licenses, permits, hiring of employees, membership in trade organizations, building authorities, regulations of fire marshals and other civil authorities, freight and express deliveries and trash removal (R. 60a-64a).

Petitioner's management, in each instance, had to take care of rentals, leasing, assessments, amortization of mortgages, mortgages, depreciation, vacation of tenants, delinquencies in rent, undesirables, investigation of prospective tenants, real estate tax valuation, percentage leases, tax participation clauses in leases and pricing of space on square foot basis (R. 60a-64a).

Finally in each case the basic management responsibilities were handled by the same person, Mr. Albert Harris, who not only selected the investments for the corporation (R. 49a; R. 59a), but also did the renting (R. 51a) and the leasing (R. 51a, 55a, 56a) and the employment (R. 51a) and also all the advertising, the operations and most of the purchasing (R. 82a).

5. RELATION OF THE CONVERTED AND REPLACEMENT PROPERTIES TO THE PETITIONER

Mr. Harris told the Tax Court that he was aware that the United Bank Building had to be replaced with similar property. He testified:

> "A I understood when we had to find another investment property to replace the United Bank Building that we were forced to sell, that we would have to have a piece of investment property that would yield us revenue which was similar to the one that we were forced to sell. Now I was submitted all types of properties; vacant land, partially improved land, factory buildings, store buildings, plants and all types of buildings which I must qualify and go in and consider taking for the Clifton Investment Company

as an investment, replacing the building that we had to sell. I surveyed the Times Square and I thought it would meet easily the requirements as the similarities in the properties pretty closely resembled one another." (R. 59a)

Mr. Harris further testified:

"When I analyzed the Times Square, I was trying to picture it from the revenues and operation thereof on a basis of approximately the same percentage for investment as we were getting out of the United Bank Building. I truthfully pictured it to realize a 10 per cent net on the investment, which was the same basis on which we bought the United Bank Building. We wanted to obtain at least a 10 per cent net on the investment." (R. 74a)

The Tax Court recognized Mr. Harris's experience in the real estate field as follows:

"The Court is convinced that you are well qualified as a real estate man. I think the preliminary examination has shown the Court that by training and experience you are competent to give an expert opinion along these lines. Now it is your opinion we want and not someone else's." (R. 73a-74a)

The Court allowed Mr. Harris to state that in his opinion the properties were similar as investments (R. 47a). The Court admitted evidence to the effect that office buildings and hotels are considered as similar investments by their owners. This evidence concerned the investment policy of two hotel chains known as Knott Corporation and Sheraton Corporation, whose investments include both office buildings and hotels.

The Knott Corporation owned the Pittsburgher Hotel, Pittsburgh, Pennsylvania, which consists of an office building and adjoining hotel controlled by one management (R.

66a). The Sheraton Corporation owns the Sheraton Whitehall Building, New York; The Penn Square Building, Philadelphia; the Sheraton Building, Washington, D. C.; and the Sheraton Building in Boston, Massachusetts (R. 66a-67a), all of which are office buildings.

6. THE PRIOR DECISIONS IN THIS CASE

The Tax Court of the United States upheld the Commissioner of Internal Revenue (R. 110a-119a) (36 TC 58) on the ground that the Tax Court has declined to follow the holding of the Fourth Circuit in *Steuart Brothers* v. *Commissioner*, 261 F 2d, 580. Instead the Tax Court followed its previous decision in *Liant Record, Inc.*, 36 T.C. 224 (1961) (reversed at 303 F 2d, 326, 1962) and *McCaffrey* v. *Commissioner*, 275 F 2d, 27.

The decision of the Tax Court was appealed to the Court of Appeals for the Sixth Circuit, which affirmed the decision of the Tax Court but rejected the functional test applied by the Tax Court, saying:

> "The Tax Court employed an erroneous test in this case, but on examination of the record, the correctness of the result is manifest."

The decision of the Circuit Court of Appeals was made by District Judges Boyd and McNamee and Circuit Judge Miller.

Petition for rehearing in banc was denied.

REASONS FOR GRANTING THE WRIT

1. CONFLICT BETWEEN DECISION OF CIRCUIT COURTS.

There are issues now presented which far transcend the question of whether this Petitioner must recognize a gain on the sale of its property. These issues concern certainty in the equal application of the tax laws, and have not heretofore been determined by this Court.

The question of interpretation of Section 1033 (a) (3) (A) of the Internal Revenue Code of 1954, and of what "similar or related in service or use" means thereunder has been submitted to six of the Circuit Courts of the United States, which have adopted four separate tests and two variations of tests. Cases involving this same question are now pending in two Circuit Courts of the United States, and innumerable cases are pending in the Tax Court of the United States or are under consideration at the various administrative levels of the Internal Revenue Service.

The vital interest in this issue arises from the gigantic forward steps taken by the United States of America in the fields of Urban Renewal, Highway Development and other similar worthy public works in the last decade and continuing into the future, and the right of condemnation which makes this possible. This vital issue does not cease because of the revision of Section 1033 in the Revenue Act, in 1958. Section 1033 was amended in 1958 by the addition of subsection (g). The amendment which was prospective only read as follows:

> "For purposes of subsection (a), if real property . . . held for productive use in trade or business or for investment is (as the result of its seizure, requisition or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of

> a like kind to be held either for productive use in trade or business or for investment, shall be treated as property similar or related in service or use to the property so converted."

As pointed out by the Court of Appeals for the Sixth Circuit, however, the law has not been changed where in cases such as the present one the replacement was by purchase of the controlling interest of stock in a corporation holding property:

> "However, the acquisition of controlling interest in stock of a corporation holding property was specifically excepted from the relaxation of the test. Title 26 U. S.C. Section 1033 (g) (1) and (2) (Technical Amendments Act of 1958)."

Under the Internal Revenue Code of 1954 there was no difference between the treatment of an outright purchase of replacement property and the purchase of controlling interest of stock in a corporation holding replacement property; however, the Technical Amendment Act of 1958 does contain such a distinction which is without obvious reason.

A review of the decisions of the respective Circuit Courts of Appeals which have decided this issue illustrates that this Section has not been interpreted uniformly.

At the time of the instant transaction, the Regulations, Section 1.1033 (a)-2(9), provided the following instruction on the meaning of "similar or related in service or use":

> "(9) There is no investment in property similar in character and devoted to a similar use if—
>
> (i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(ii) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(iii) The owner of a requisitioned tug uses the proceeds to buy barges."

Historically the first Court to interpret Section 1033 was the Board of Tax Appeals of the United States.

The Board of Tax Appeals in the case of *M. J. Caldbeck Corp.*, 36 B.T.A. 452, considered a case where the taxpayer had owned an opera house which had been remodeled to provide two ground-floor stores and a motion picture theater on the second floor. After a fire destroyed the building, the taxpayer leased the property under an agreement to construct a new building for the lessee to use as a department store. Significantly the taxpayer had actually operated the motion picture theater prior to the fire. The Board of Tax Appeals concluded that the old and new buildings were "similar or related in service or use" within the meaning of the statute since both were business properties and the "statute does not require exact physical duplication."

Next to consider the issue was the Tax Court of the United States. That Court found in *Winter Realty & Construction Co.* v. *Commissioner*, 2 T.C. 38 (1943) (Affirmed in part 149 F 2d, 567) (cert. denied, 326 U.S., 754) that conversion from an integrated commercial and apartment building to a purely commercial building satisfied the prerequisite that the acquired property and the converted property be similar or related in service or use.

On February 6, 1960, the question was decided by the Court of Appeals for the Third Circuit in *McCaffrey* v. *Commissioner*, 275 F 2d, 27 (1960), cert. denied, 363 U.S. 828 affirming 31 T.C. 505 (1958). In the *McCaffrey* case the taxpayer owned real property and leased it to a tenant

for use as a parking lot. The proceeds of a condemnation of such property were used to purchase stock of a corporation owning real estate leased to the government for warehouse purposes.

In affirming the Tax Court's decision that the taxpayer was not entitled to non-recognition of gain, the Third Circuit agreed with the Tax Court's employment of the "functional" test. The so-called "functional" test (under which the physical use of the involuntarily-converted property and the replacement property is compared to determine whether such properties are "similar or related in service or use") is, therefore, the interpretation of Section 1033 which is still the law in the Third Circuit.

The Court of Appeals for the Fourth Circuit in *Steuart Brothers v. Commissioner*, 261 F 2d, 580 (1958) reversing 29 T.C. 372 (1957) took a diametrically opposed view to the Third Circuit in the *McCaffrey* case.

In the *Steuart* case the taxpayer replaced the converted property, upon which it planned to erect warehouses for rental, by investing the proceeds in rental properties containing garages, service stations and automobile sales rooms, and the Court specifically rejecting the functional test in an investor situation, held that the taxpayer was entitled to non-recognition of gain. Thus the law in the Fourth Circuit now differs from that in the Third Circuit.

Next to consider the question was the Court of Appeals for the Second Circuit in *Liant Record, Inc.*, v. *Commissioner*, 303 F 2d 326 (May 21, 1962) reversing 36 T.C. 224.

In that case the taxpayers took the proceeds from a condemnation of an office building housing only commercial tenants, including a bank, attorneys, accountants, real estate firms, a doctor and a dentist (with no sleeping rooms whatsoever), and reinvested them in three apartment buildings containing collectively 175 apartments, 7 maids' rooms and minor commercial tenants, viz., a restaurant, stationery

store, tailor shop, supermarket, physician's office and dentist's office. All the apartments were typical residential apartments having fully-equipped kitchens.

The Court of Appeals for the Second Circuit in reversing the Tax Court's decision and remanding to the Tax Court for further consideration in light of its opinion, adopted still another test to be applied to the words "similar or related in service or use." The Second Circuit rejected completely the "functional" test adopted by the Third Circuit in the *McCaffrey* case, rejected the double standard (user vs. investor), set up by the Fourth Circuit in the *Steuart* case, and advanced as its own the "relation of the properties to the taxpayer" test. Under this test the properties must be reasonably similar in their relation to the taxpayer. This reasonableness is dependent upon a number of factors, all bearing on whether or not the relation of the taxpayer to his properties is similar. The test is not concerned with the ultimate use to which the properties are put, when the taxpayer is not the user of the properties as in the case under consideration.

The Second Circuit would apply a single test to both users and investors, viz., a comparison of the services or uses of the original and replacement properties to the taxpayer owner. Among the relevant factors in applying the "relation of the properties to the taxpayer" test the Second Circuit mentions:

> "In applying such a test to a lessor, a Court must compare, inter alia, the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of his business risks connected with the properties."

Thus once again the taxpayer in the Second Circuit is controlled by a different interpretation of the law from his brothers in the Third or Fourth Circuit.

On August 1, 1962, the Court of Appeals for the Eighth Circuit in *Loco Realty Company* v. *Commissioner*, 306 F 2d, 207 (1962) reversing 35 T.C. 110, in considering the question, presented an exhaustive survey of all the pertinent cases in the Tax Court and the District Courts as well as the Courts of Appeals, pointing out the basic differences between them.

In that case, as pointed out in the opinion of the Tax Court, Petitioner's business was that of owning buildings for investment purposes. The Petitioner owned property which was leased to a shoe manufacturer which subleased the first floor to a company whose business was combing leather for shoes. This property was taken by condemnation. By a very complicated series of transactions the proceeds of the condemnation were utilized to purchase, alter and repair a replacement property leased as an office and warehouse to a wholesale grocer.

The Eighth Circuit Court concludes that it feels "that the statute must be viewed in the light of its application to the taxpayer and is to be tested by the taxpayer's activities and not by those of its tenants or other persons."

The test used by the Eighth Circuit rejected the statements in the *Steuart* case and in the *Liant* case that both properties need only qualify as investments, and formed a synthesis of the prior decisions into a test which states that it is sufficient if in addition to the leasehold characteristics there is a reasonable similarity to the properties themselves.

The Court did not remand, but rather reversed the Tax Court decision as clearly erroneous. The Court emphasized that "the statute was not intended to penalize but to protect persons whose property may be taken on condemnation and accordingly, should be construed liberally. Thus there is added yet another test which may be applied.

On October 19, 1962, the Court of Appeals for the

Seventh Circuit in *Ben Pohn & Estelle Pohn* v. *Commissioner of Internal Revenue*, 309 F 2d 427 (CA 7) 1962, reversing 20 TCM 163 (1961) considered this issue. In the *Pohn* case taxpayers acquired a leasehold interest in vacant Chicago land in 1933. The lessor owned property on which was a filling station, which was taken in condemnation. The proceeds of the award were invested in a one-fourth interest in Florida vacant land, and subsequently this vacant property was leased for construction of apartments.

The Seventh Circuit found the decision in the *Liant* case to afford the most persuasive of the many tests considered by it, finding "continuity of interest" to be the key factor. It found that the taxpayers would have continued their lessor's interest in the property had it not been interrupted by the condemnation, that the "service or use" to taxpayer was production of rental income and that the "service or use" of the replacement property to them is similar or related.

On February 6, 1963, the Court of Appeals for the Sixth Circuit decided *Clifton Investment Company* v. *Commissioner of Internal Revenue*, 312 F 2d 719 (1963), the facts of which have been stated *supra*. The Sixth Circuit differed with the Tax Court and the Third Circuit in the *McCaffrey* case, stating:

> "We reject the functional test as applied to the holder of investment property who replaces such property with other property, as in the case at bar."

The Sixth Circuit majority was most impressed by the decision in the *Liant* case which it considered to advance the soundest approach among the number of decisions on this point. It found that Congress must have intended that in order for the taxpayer to obtain the tax benefits of Section 1033 he must have continuity of interest as to

the original property and its replacement in order that the taxpayer not be given a tax-free alteration of his interest. Thus the Sixth Circuit has in measure adopted the test in the *Liant* case.

Circuit Judge Miller in his concurrence was unwilling however to adopt, without some modification thereof, the test adopted and applied in *Liant Record, Inc.*, v. *Commissioner*, 303 F 2d, 326 (CA 2) upon which the majority relies. It seems to him that the *investment character* (emphasis ours) of the properties involved should be given more consideration than is given by the ruling in the *Liant* case, although he does not think that investment basis alone is sufficient to comply with the statute as *Steuart Bros., Inc.*, v. *Commissioner*, 261 F 2d, 580 (CA 4), might be construed as holding. He adopts the view pointed out in *Loco Realty Co.* v. *Commissioner*, 306 F 2d, 207 (CA 8), that the statute was not intended to penalize but to protect persons whose property may be taken in condemnation and accordingly should be construed liberally.

Judge Miller stated:

> "However, I am not willing to adopt, without some modification thereof, the test adopted and applied in *Liant Record, Inc.*, v. *Commissioner*, 303 F 2d 326, C. A. 2nd, upon which the majority opinion relies. I think that the investment character of the properties involved should be given more consideration than what seems to me is given by the ruling in the *Liant* case, although I do not think that investment basis alone is sufficient to comply with the statute, as *Steuart Brothers, Inc.*, v. *Commissioners*, 261 F 2d 580, C. A. 4th, might be construed as holding. As pointed out in *Loco Realty Co.* v. *Commissioner*, 306 F. 2d 207, C. A. 8th, the statute was not intended to penalize but to protect persons whose property may be taken in condemnation and, accordingly, should be construed liberally. I agree with the standard adopted in the

opinion in that case, although for our present purposes I do not think that it results in a reversal of the decision of the Tax Court."

Therefore while there is unanimity in the decision in the Sixth Circuit, there is a split on ideology, the majority favoring the decision in the *Liant* case, and the minority unwilling to adopt the *Liant* case and urging an approach to the question more in line with the decision in the *Loco* case.

On March 15, 1963, the Court of Appeals for the Sixth Circuit in *The Capital Motor Car Company* v. *Commissioner of Internal Revenue*, — F 2d — (TCM 1962-64) reversed the decision of the Tax Court and remanded the case for further proceedings not inconsistent with its Per Curiam opinion.

The taxpayer in the *Capital* case was the owner of improved land with a building on it located in Columbus, Ohio. Prior to 1949 the taxpayer used the property for the operation of its automobile sales and service business. Subsequently the property was rented to an automobile agency, later to a school, and finally to Ohio Fuel Gas Company for a paint shop and other purposes connected with the production, transportation and distribution of gas. The property was condemned and the taxpayer invested a portion of the award in the purchase of unimproved land consisting of 3.9 acres in said City. Later the taxpayer contracted to build a motel on this land and to lease it to a corporation upon completion. The taxpayer was unable to obtain financing to build the motel, and still later the lease was modified to provide that the lessee construct the motel. On these facts the Sixth Circuit found no substantial difference in the relation between the lessor and lessee of the converted property and of the replacement property when the motel was completed.

In the *Capital* case a taxpayer which at one time had

been a user and became a lessor was entitled to invoke the non-recognition provisions of 1033 (a) (3) (A), where it re-invested proceeds of condemnation in vacant land on which another party constructed a motel. Thus the proceeds of improved real estate were invested in unimproved real estate which was subsequently developed by another.

In *Fillipini* v. *United States*, 200 F. Supplement, 286 N.D. (California 1961) (on appeal to the Court of Appeals for the Ninth Circuit) the District Court held that the investment in an office building of proceeds from the conversion of agricultural and rural property did not qualify for a recognition. What interpretation of the section will be advanced by that Court remains to be determined.

In *United Development Company* v. *United States of America*, — F Supp — (10 AFTR 2d 6140) (E.D.M.O. 1962), the District Court held that gain was recognized when a cemetery company used part of the proceeds of condemnation of a burial land to invest in its new administration building on a portion of its remaining land, the Court saying that the new building was not a replacement similarly related in service or use.

This latter case is now on appeal to the Court of Appeals for the Eighth Circuit.

This unsettled state in the interpretations of a taxing statute which has daily applicability, cries out for a decision by this Court which will delineate to all persons whose property is taken in the furtherance of our national interest what their rights may be, and for this Court to establish a uniform rule of law which may be applied by all Courts. Useless litigation, conflict in decisions and confusion in the minds, both of those whose property is taken and of those who are charged with the responsibility for applying the taxing laws of the United States, will be

avoided by a pronouncement on this question by this Court.

The City of Cincinnati alone during the six years 1957 through 1962 condemned 4,342 parcels of property at a total condemnation cost of $73,018,954.00. This pattern is repeated throughout our great nation as it moves ahead, and it is just beginning.

2. RELATION OF THE CONVERTED AND REPLACEMENT PROPERTIES TO THE PETITIONER

The Court in the case of this Petitioner specifically found that it was an investor which replaced investment property with other investment property, that it was not a user and that what the taxpayer derived from both properties herein was generally the same, viz., rental income. (Appendix pp. 31 and 33).

The Court found, however, that what the properties demanded of the taxpayer in the way of management services and relation to its tenants materially varied.

From the Opinion and from the reference to the *Clifton* case in the *Capital* case it appears that the decision against the taxpayer hangs upon the thread of its management activities. A corporation's policy as to investment and as to all other matters is formulated by its owners, officers and directors. Albert Harris, the Petitioner's President and Treasurer and chief shareholder, provided the only management which Petitioner had. Mr. Harris was the driving force of the Petitioner and Mr. Harris had owned in corporate form or individually a great number of properties, among them hotels, office buildings and apartment buildings. Mr. Harris provided the same management activities to all these properties. To him, and therefore to the companies he owned and managed, all these prop-

erties bore the same relation. He explained in great detail the similarities in the management duties he performed in the instance of each of these properties. The management of these properties formed the pattern of his business life.

It is a fiction to say that there is a material variance between the relation of an office building and a hotel to a corporation which is controlled by a man who for over forty years has owned and managed corporations which own both hotels and office buildings.

It is significant to note that on remand, the Tax Court in *Liant Records, Inc.* (TC Memo 1963-53) found that while the taxpayer had used an independent firm to manage the office building, while managing the apartment buildings through its own employees, this was not significant, but that the controlling factors were that the buildings were both in good areas of New York with similar financing and insurance coverage available. Contrast this with the Sixth Circuit's determination that the fact that replacement building had a resident manager (despite testimony that the leasing, purchasing, advertising and general management were done by Mr. Harris) is a material variance. This is one further example of the disparity in treatment of the issue, which continues to prevail sans a pronouncement by this Court.

Not deemed significant by counsel for the Petitioner prior to the rendering of the decision in the *Clifton* case and in the *Capital* case, was the fact that on July 5, 1962, the Times Square Hotel of New York, Inc. (the corporation in which Petitioner had purchased an 80 percent stock interest) leased the entire Times Square Hotel premises to The Hotel Times Square Associates, a New York Limited Partnership. Possibly if this had been argued to the Circuit Court, the outcome of the case might have differed. This writer thinks not. This writer has made

reference to this fact to make this Court aware of the indecision which the current state of the law produces.

On the narrower issue this case should have been remanded by the Sixth Circuit for further consideration in light of its adoption of the *Liant* case test. The relation of these properties to this taxpayer has never been fully explored in that Court as the pronouncement of the test to be applied to the law followed the trial.

On the larger issue the Petitioner asks this Court to announce what is the proper test to be applied in interpreting Section 1033, that Section which has caused so many courts so much reflection and dissent, but which still is very much a part of the law of involuntary conversion.

3. WHO MAY DECIDE PETITION FOR REHEARING IN BANC

The question presented is, may the determination of whether a re-hearing in banc should be granted, be determined by the original panel, a quorum of which was comprised of District Judges sitting by designation or whether the entire Court or a panel, a majority of which are active Circuit Judges, must pass upon the petition for re-hearing in such case.

This Court has held that:

> "Consistent with the statute, the Court may, as has been shown, adopt a practice whereby the majority of the full bench may determine whether there will be a hearing or re-hearing in banc, or they may delegate the responsibility for the initiation of the in banc power to the Division of the Court." *Western Pacific Railroad Corp.* v. *Western Pacific Railroad Co.*, 345 U.S. 247 (April 1953).

The Court's ruling is based upon an illuminating discussion of Title 28, U. S. Code, Section 46(c) (Appendix pp. 41 & 42) wherein this Court concludes that that Section's purpose is for the information of the Courts of Appeals and not for litigants. However, this Court advises the Courts of Appeals that they should recognize the value of an efficient use of the in banc power and should therefore adopt such means as will enable their full membership to determine whether the Court's administration of the power is achieving the full purpose of the statute. This Court reflected that it is essential that litigants be left free to suggest to the Court, or to the Division depending upon where power of initiation resides, as determined by the active judges of the Court, that a particular case is appropriate for consideration by all the Judges, and that if in the exercise of its discretion under Section 46(c) a Court denies litigants the privileges of reaching the ear of every Circuit Judge on the in banc question, there is still no reason to deny them access to the few *Circuit* Judges (emphasis writer's) who must act initially and perhaps decisively on the matters for the others.

In the present case the Petitioner has never been able to reach the ear of more than one of the active Judges of the Sixth Circuit, which Judge differed in his concurrence as to the test to be applied. Justice Frankfurter in his concurrence in the *Western Pacific* case indicated that, while he was not particularly enamored of rehearing procedure, he did not see how any procedure could be proper whose effect is not to apprise all active Judges either of all decisions of panels of the Court or of those decisions which counsel brings to the Court's attention, by motion or suggestion, as raising the problems at which the grant of power in Section 46 (c) is directed. Justice Frankfurter concluded:

"For this reason I do not believe that a delegation of authority to the panel which heard the case to dispose finally, in behalf of the entire court, of petitions for rehearing in banc – if there are to be such petitions and if through them alone Section 46(c) is to be implemented – would constitute adoption of a permissible procedure for the exercise of the power conferred by Section 46(c). It may be proper to require petitions for rehearing in banc to be made to the panel in the first instance, but to allow the discretionary function under Section 46(c) to be fully discharged definitively by the panel whose judgment may call for in banc action is to treat the statute as an empty, purposeless form of words."

This writer is not unmindful of the fact that the Sixth Circuit Court of Appeals in *National Latex Products Company v. Sun Rubber Co.*, 276 F 2d, 167 (1960) stated that a rule long established and never deviated from by the Sixth Circuit Court is that in cases heard and decided by a regular division of three Judges presenting similar motions for in banc proceedings, a petition to rehear and reconsider should not be considered by the Court in banc.

However, the published rules of the Court of Appeals for the Sixth Circuit provide:

"Rule 3(1) – Assignment of Judges – Quorum – The Judges of this Court shall, as provided in Title 28 U.S.C. (F.C.A.) Section 46, be assigned to sit upon the Court and its divisions in such order, at such sessions and for the hearing of such cases as the Court directs. Cases and controversies shall be heard and determined by a Court or division of not more than three Judges, *unless a hearing or rehearing before the Court in banc is ordered by a majority of the Circuit Judges of the Circuit who are in active service.* (emphasis writer's). A Court in banc shall consist of all active Circuit Judges of the Circuit. A majority of the number of Judges authorized to constitute the Court or a quorum thereof, shall constitute a quorum."

The second question presented by this petition then, is one which concerns judicial administration. It is respectfully submitted that in the words of Justice Stewart in *United States* v. *American Foreign Steamship Corp.*, 363, U.S. 685,

> "when such circumstances appear, in banc determinations make for more efficient judicial administration, conflicts within a Circuit will be avoided, familiarity of decision in the Circuit Courts of Appeals will be promoted."

It is respectfully submitted that the proper application of in banc hearings and rehearings will ultimately lighten the work of this esteemed Court.

4. SUMMARY OF QUESTIONS PRESENTED

The first question presented by this case has never been decided by this Court and on two occasions opposite results arising out of decisions of Circuit Courts of the United States have been refused entry. See *McCaffrey* v. *Commissioner, supra,* and *Winter Realty & Construction Co.* v. *Commissioner, supra.* The increased volume of condemnation arising from the great forward strides in the development of public facilities in the United States in the past decade, which will certainly continue into the future, coupled with the uncertainty in the law as to the tax consequences of such condemnation to the person whose property is taken, make it particularly appropriate that this Court exercise its discretionary jurisdiction in this case.

The second question presented is likewise a new inquiry into the adjudicatory procedures of the Courts of Appeals which should be resolved.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX

No. 14738

UNITED STATES COURT OF APPEALS
For the Sixth Circuit

THE CLIFTON INVESTMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

(Decided February 6, 1963.)

Before: MILLER, Circuit Judge, BOYD and McNAMEE, District Judges.

BOYD, J. Petitioner is a real estate investment corporation organized and existing under the laws of the State of Ohio, with headquarters in Cincinnati. In 1956 the petitioner sold to the City of Cincinnati under its threat of exercising its power of eminent domain a six-story office building, known as the United Bank Building, located in the downtown section of that city, which building was held by petitioner for production of rental income from commercial tenants. The funds realized from the sale of this property to the city were used by the petitioner to purchase eighty percent of the outstanding stock of The Times Square Hotel of New York, Inc., also an Ohio corporation, which had as its sole asset a contract to buy the Times Square Hotel of New York City. The purchase of the hotel was effected by the corporation. The taxpayer-petitioner contends herein that the purchase of the controlling stock

in the hotel corporation was an investment in property "similar or related in service or use" to the office building it had been forced to sell, thus deserving of the non-recognition of gain provisions of Section 1033 (a) (3) (A), Internal Revenue Code of 1954 (Title 26 U. S. C., Section 1033 (a) (3) (A).[1] More specifically, the taxpayer contends that since both the properties herein were productive of rental income, the similarity contemplated by the statute aforesaid exists. The Commissioner ruled to the contrary, holding that any gain from the sale of the office building was recognizable and a deficiency was assessed against the taxpayer for the year 1956 in the amount of $19,057.09. The Tax Court agreed with the Commissioner, finding that the properties themselves were not "similar or related in service or use" as required by the statute. 36 T. C. No. 58, 1961. From the decision of the Tax Court this appeal was perfected.

In order to determine whether the requisite similarity existed under the statute between the properties herein, the Tax Court applied the so-called "functional test" or "end-use test." This it seems has been the Tax Court's traditional line of inquiry, when similar cases under the within statute have been considered by it. This approach

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[1] "Sec. 1033. (a) General Rule. If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted. . . .

"3. Conversion into Money where Disposition Occurred after 1950. Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2) occurred after December 31, 1950, the gain (if any) shall be recognized eccept [except] to the extent hereinafter provided in this paragraph:

"(A) Nonrecognition of gain. If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property at the election of the taxpayer the sale shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. . . ."

takes into account only the actual physical end use to which the properties involved are put, whether that use be by the owner-taxpayer or by his tenant; that is, whether the taxpayer-owner is the actual user of the property or merely holds it for investment purposes, as in the case of a lessor. We reject the functional test as applied to the holder of investment property, who replaces such property with other investment property, as in the case at bar.

The Tax Court in this case relied in part on its earlier decision in *Liant Record, Inc.* v. *Commissioner*, 36 T. C. 224 and chiefly on the decision of the Court of Appeals for the Third Circuit in *McCaffrey* v. *Commissioner*, 275 F. 2d 27, 1960, cert. denied 363 U. S. 828, the latter case approving and applying the aforesaid functional test in such a case as here presented. However, the Court of Appeals for the Second Circuit has since reversed the Tax Court's decision in *Liant*, 303 F. 2d 326, 1962, and in so doing advanced what we consider to be the soundest approach among the number of decisions on this point. We need not here review all the relevant decisions, since this is done in the recent cases of *Loco Realty Company* v. *Commissioner*, 306 F. 2d 207 (C.A. 8) 1962, and *Pohn* v. *Commissioner*, —— F. 2d —— (C.A. 7) 1962, both of which decisions approved the Second Circuit Court's approach in *Liant*, the court in the *Pohn* case relying specifically on the *Liant* decision.

Congress must have intended that in order for the taxpayer to obtain the tax benefits of Section 1033 he must have continuity of interest as to the original property and its replacement in order that the taxpayer not be given a tax-free alteration of his interest. In short, the properties must be reasonably similar in their relation to the taxpayer. This reasonableness, as noted in the *Liant* case, is dependent upon a number of factors, all bearing on whether or not the relation of the taxpayer to the property

has been changed. The ultimate use to which the properties are put, then, does not control the inquiry, when the taxpayer is not the user of the properties as in the case under consideration As exemplary of the factors which are relevant the *Liant* decision mentions the following, after advancement of its "relation of the properties to the taxpayer" test:

> "In applying such a test to a lessor, a court must compare, inter alia, the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of his business risks connected with the properties."

Thus, each case is dependent on its peculiar facts and the factors bearing on the service or use of the properties to the taxpayer must be closely examined. The Tax Court employed an erroneous test in this case, but on examination of the record, the correctness of the result is manifest.

The record before us discloses that the United Bank Building and the Times Square Hotel both produced rental income to the taxpayer. However, examination of what the properties required in the way of services to the tenants, management activity, and commercial tenancy considerations reveals an alteration of the taxpayer's interest. The record herein shows that the taxpayer corporation itself managed the United Bank Building, but deemed it necessary to procure professional management for the Times Square Hotel. There were primarily two employees for the United Bank Building, who afforded elevator and janitorial services to the tenants. In the Times Square Hotel between 130 and 140 employees were necessary to attend the hotel operation and offer services to the commercial tenants and hotel guests. Approximately 96% of the rental income from the hotel was from the guest room facilities and the large number of transients required daily

services of varying kinds. Furniture, linens, personal services of every description were furnished the hotel guests, which were not furnished the commercial tenants of the United Bank Building. The hotel guests reside in the hotel rooms and that is obviously the only reason they are tenants. In the office building herein several tenants also used parts of the premises for living quarters, but were clearly not furnished the typical services the hotel guest demands. There was no great limitation placed on the types of commercial tenants to whom space was rented in the United Bank Building, but as the enumeration of commercial tenants of the hotel building reveals, space therein was leased for the most part and primarily with an eye to how such a business operation might fit in with the operation of a hotel, how it relates to the hotel guests. It is common experience, that the services offered by a lessee of business premises in a hotel will reflect in the minds of its guests on the service they associate with the hotel itself. If a leased restaurant in a hotel offers good or bad service, there is a tendency to think of the food service at the hotel as good or bad. A number of unique business considerations enter when leasing commercial space in a hotel which do not apply to an office building.

We consider there to be, then, a material variance between the relation of the office building in question and the within hotel operation to the taxpayer, in the light of the relevant inquiry found in the *Liant* case. It is true that what the taxpayer derived from both properties herein was generally the same, rental income. But what the properties demanded of the taxpayer in the way of management, services, and relations to its tenants materially varied. That which the taxpayer receives from his properties and that which such properties demand of the taxpayer must both be considered in determining whether or not the

properties are similar or related in service or use to the taxpayer.[2]

MILLER, Circuit Judge, concurring. I concur in the result reached in the majority opinion.

However, I am not willing to adopt, without some modification thereof, the test adopted and applied in *Liant Record, Inc.* v. *Commissioner,* 303 F. (2) 326, C. A. 2nd, upon which the majority opinion relies. I think that the investment character of the properties involved should be given more consideration than what seems to me is given by the ruling in the *Liant* case, although I do not think that investment basis alone is sufficient to comply with the statute, as *Steuart Brothers, Inc.* v. *Commissioner,* 261 F. (2) 580, C. A. 4th, might be construed as holding. As pointed out in *Loco Realty Co.* v. *Commissioner,* 306 F. (2) 207, 215, C. A. 8th, the statute was not intended to penalize but to protect persons whose property may be taken on condemnation and, accordingly, should be construed liberally. I agree with the standard adopted in the opinion in that case, although for our present purposes I do not think that it results in a reversal of the decision of the Tax Court.

The decision of the Tax Court is affirmed.

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[2] Congress has since provided that replacement of property held for productive use in trade or business or for investment purposes with property of "like kind" satisfies the "similar or related in service or use" requirement. However, the acquisition of controlling interest in stock of a corporation holding property was specifically excepted from the relaxation of the test. Title 26 U.S.C. Section 1033 (g) (1) and (2). (Technical Amendments Act of 1958).

(CAPTION OMITTED)

ORDER

(Filed March 11, 1963.)

Before: MILLER, Circuit Judge, BOYD and McNAMEE, District Judges.

Appellant's petition for rehearing in banc having been considered by the court;

IT IS ORDERED that said petition be and the same is hereby denied.

Approved for entry:

MARION S. BOYD
United States District Judge
sitting by designation

INTERNAL REVENUE CODE OF 1954:

Sec. 1033. Involuntary Conversions.

(a) *General Rule.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * *

(3) *Conversion Into Money Where Disposition Occurred After* 1950.—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) *Nonrecognition of Gain.*—If the taxpayer during the period specified in subparagraph (B), for the

purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. * * *.

(26 U.S.C. 1958 ed., Sec. 1033.)

* * * *

Treasury Regulations on Income Tax (1954 Code):

Section 1.1033(a)-2. *Involuntary conversion where disposition of the converted property occurred after December* 31, 1950—(a) *In general.*—This section applies only with respect to involuntary conversions where the disposition of the converted property occurred after December 31, 1950, and where the proceeds are received in a taxable year to which the Internal Revenue Code of 1954 applies. The term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b). *Conversion into similar property.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such nonrecognition of gain is mandatory.

(c) *Conversion into money or into dissimilar property.* —(1) If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period specified in subparagraph (3) of this paragraph. For the purposes of section 1033 the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(2) All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement) shall be reported in the return for the taxable year or years in which any of such gain is realized. An election to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph shall be made by including such gain in gross income for such year or years only to such extent. If, at the time of filing such a return, the period within which the converted property must be replaced has expired, or if such an election is not desired, the gain should be included in gross income for such year

or years in the regular manner. A failure to so include such gain in gross income in the regular manner shall be deemed to be an election by the taxpayer to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph even though the details in connection with the conversion are not reported in such return. If, after having made an election under section 1033(a)(3), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such recomputation should be in the form of an "amended return." If a decision is made to make an election under section 1033(a)(3) after the filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed. If the replacement of the converted property occurs in a year or years in which none of the gain on the conversion is realized, all of the details in connection with such replacement shall be reported in the return for such year or years.

(3) The period referred to in subparagraphs (1) and (2) of this paragraph is the period of time commencing with the date of the disposition of the converted property, or the date of the beginning of the threat or imminence or requisition or condemnation of the converted property, whichever is earlier, and ending one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may be designated pursuant to an application of the taxpayer. Such application shall be made prior to the

expiration of the one year after the close of the first taxable year in which any part of the gain from the conversion is realized, and shall contain all of the details in connection with the involuntary conversion. Such application shall be made to the district director for the internal revenue district in which the return is filed for the first taxable year in which any of the gain from the involuntary conversion is realized. No extension of time shall be granted pursuant to such application unless the taxpayer can show reasonable cause for not being able to replace the converted property within the required period of time

(4) Property or stock purchased before the disposition of the converted property shall be considered to have been purchased for the purpose of replacing the converted property only if such property or stock is held by the taxpayer on the date of the disposition of the converted property. Property or stock shall be considered to have been purchased only if, but for the provisions of section 1033 (c), the unadjusted basis of such property or stock would be its cost to the taxpayer within the meaning of section 1012. If the taxpayer's unadjusted basis of the replacement property would be determined, in the absence of section 1033(c), under any of the exceptions referred to in section 1012, the unadjusted basis of the property would not be its cost within the meaning of section 1012. For example, if property similar or related in service or use to the converted property is acquired by gift and its basis is determined under section 1015, such property will not qualify as a replacement for the converted property.

(5) If a taxpayer makes an election under section 1033 (a)(3), any deficiency, for any taxable year in which any part of the gain upon the conversion is realized, which is attributable to such gain may be assessed at any time before the expiration of three years from the date the district director with whom the return for such year has been

filed is notified by the taxpayer of the replacement of the converted property or of an intention not to replace, or of a failure to replace, within the required period, notwithstanding the provisions of section 6212(c) or the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain all of the details in connection with such replacement. Such notification should be made in the return for the taxable year or years in which the replacement occurs, or the intention not to replace is formed, or the period for replacement expires, if this return is filed with such district director. If this return is not filed with such district director, then such notification shall be made to such district director at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such district director before the filing of such return.

(6) If a taxpayer makes an election under section 1033 (a)(3) and the replacement property or stock was purchased before the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending before such last taxable year, which is attributable to such election may be assessed at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 6212 (c) or 6501 or the provisions of any law or rule of law which would otherwise prevent such assessment.

(7) If the taxpayer makes an election under section 1033 (a)(3), the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the replacement property or stock, regardless of whether such amount is realized in one or more taxable years.

(8) The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been

(9) There is no investment in property similar in character and devoted to a similar use if—

(i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(ii) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(iii) The owner of a requisitioned tug uses the proceeds to buy barges.

* * *

TITLE 28, SECTION 46, U. S. CODE

* * *

46. *Assignment of judges — Divisions — Hearings — Quorum.* — (a) Circuit judges shall sit on the court and its divisions in such order and at such times as the court directs.

(b) In each circuit the court may authorize the hearing and determination of cases and controversies by separate divisions, each consisting of three judges. Such divisions shall sit at the times and places and hear the cases and controversies assigned as the court directs.

(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit.

(d) A majority of the number of judges authorized to constitute a court or division thereof, as provided in paragraph (c), shall constitute a quorum. (June 25, 1948, c. 646, § 1, 62 Stat. 871.)

* * *

36 T. C. No. 58

TAX COURT OF THE UNITED STATES

Docket No. 81999

(CAPTION OMITTED)

OPINION OF THE TAX COURT

(Filed June 27, 1961.)

HELD, that the money which petitioner received in 1956 from the City of Cincinnati, Ohio, in settlement for the condemnation of an office building and ground upon which it was located and which the petitioner held for rental purposes, was not invested in other property "similar or related in service or use" where petitioner invested the money in the shares of stock in an Ohio corporation which acquired a hotel building in the city of New York. Petitioner is not entitled to the non-recognition of gain provisions of section 1033, I. R. C. 1954.

IRVING HARRIS, Esq., for the Petitioner.
CONLEY G. WILKERSON, Esq., for the respondent.

The Commissioner has determined a deficiency in petitioner's income tax for the fiscal year ended November 30, 1956, of $19,057.09. The deficiency is due to two adjustments made to the income reported on petitioner's return, as follows:

(a)	Gain realized on involuntarily converted property	$75,628.37
(b)	Lease cancellation expense	500.00

Adjustment (a) is explained in the deficiency notice as follows:

(a) It is held that you are not entitled to nonrecognition of gain realized on involuntarily converted property as provided in Section 1033 of the Internal Revenue Code (1954) since that which was acquired was not similar or related in service or use to the property converted.

Petitioner does not assign error as to adjustment (b). It does contest by appropriate assignments of error the Commissioner's adjustment (a).

FINDINGS OF FACT

Some of the facts are stipulated and are found as stipulated and are incorporated herein by this reference.

Petitioner is a corporation organized and existing under the laws of the State of Ohio, with its office in Cincinnati. It filed its income tax return for the taxable year ended November 30, 1956, with the district director of internal revenue, Cincinnati.

It is stipulated that—

> The petitioner was formed for the purpose of purchasing and otherwise acquiring, holding, owning, mortgaging, pledging, selling, transferring, and in any manner disposing of, and transacting in and with real property, and goods, wares, merchandise, and other personal property of any and every class and description; the acting, as agent or representative of individuals, firms, or corporations, and as such to manage, develop and extend business interests of such prin-

cipals; to carry on any other lawful business and to do anything and everything necessary, suitable, or convenient or proper for the accomplishment of any of the purposes of the attainment of any or all of the objects hereinbefore enumerated or incident to the powers herein named and to have all the rights, powers, and privilege now or hereafter conferred by the laws of the State of Ohio upon corporations organized under the General Corporation Law of Ohio.

Petitioner is primarily a realty company whose business activities include purchasing and owning investment real estate held by the petitioner for the production of income to the petitioner.

On or about June 10, 1946, petitioner acquired, by purchase, land with a building thereon known as the United Bank Building located at the southeast corner of Third and Walnut Streets, Cincinnati, and owned the land and building until its sale to the City of Cincinnati on or about January 16, 1956, which sale was made and completed under the threat of exercise of the power of eminent domain by the City of Cincinnati. The United Bank Building was a 6-story building of masonry construction and was used by petitioner to produce a rental income from various tenants. Immediately prior to the sale of the United Bank Building by petitioner space was rented in the building to individuals or business concerns for the following commercial purposes:

Night Club, Restaurant and Bar
Air Conditioning Products
Boat Supply Sales
Artists' Studios
Coffee Mill Sales Agent
Optical Supply House
Theatrical Supplies
Commercial Artist
Offices
Music Studio
Mercantile Agent
Editorial Office Magazine
Textile Supply
Wholesale Sportswear
Advertising Agency
Sculptor Studio
Advertising Dept. (Sign Shop)
Law Office Storage
Photo-engraver
Lens Grinder
Surgical Instrument Repair
Elevator Co. offices

In some instances tenants used, and were permitted to use, offices and studios occupied by them as sleeping rooms.

The amount received by petitioner from the sale of the United Bank Building was $159,182.93. At the time of the sale the property had an adjusted basis of $76,554.56. The expenses of the sale amounted to $7,000. The gain accruing to petitioner from the sale of the United Bank Building was in the amount of $75,628.37.

On or about January 20, 1956, petitioner invested all the proceeds received from the sale of the United Bank Building, plus additional sums, in the purchase, for $250,000, of 80 percent of the voting stock and 80 percent of the outstanding stock of all classes of The Times Square Hotel of New York, Inc., an Ohio corporation. The Times Square Hotel of New York, Inc., was incorporated in the State of Ohio on November 2, 1955. Its purpose was, as stated in the stipulation of facts filed by the parties:

> to purchase, lease or in any manner to own, hold, improve and develop for any and all purposes, and to sell, convey, lease, mortgage, or in any manner dispose of, or deal with lands, and real property, and any estate of interest therein; to contract, acquire by purchase, lease, or otherwise own, operate, manage, supervise and conduct and to sell, lease mortgage, or otherwise dispose of hotels, apartments, apartment houses, inns, lodging houses, garages and buildings, structures, and properties of all kinds.
>
> To engage in, conduct and carry on in any and all branches thereof, the business, or business of hotel keepers, innkeepers, and garage operators; and to own, operate, manage, supervise and contract to grant concessions, rights, or license to others to operate, manage or otherwise dispose of, or deal with restaurants, cafes, bars, all kinds of busifiess stores and offices, broad-

casting stations, place of amusements and entertainment of all kinds.

To carry on any lawful business and to do any and everything necessary, suitable, convenient or proper for the accomplishment of any of the purposes hereinbefore enumerated, or incidental to the powers herein named or for the enhancement of the value of the property of the corporation or which shall at any time appear conducive thereto or expedient.

At the time of petitioner's purchase of 80 percent of the voting stock and 80 percent of all outstanding classes of stock of The Times Square Hotel of New York, Inc., the only asset of The Times Square Hotel of New York, Inc., was a contract to purchase the Hotel Times Square located at 255 West 43rd Street, New York City. The Hotel Times Square building is a corner building of brick, concrete, and steel construction, 15 stories in height, plus a partial sixteenth floor.

For the period January 1, 1958, to December 31, 1958, which the parties agree is a representative year, guest and meeting room revenue amounted to $987,970.71 and commercial space revenue amounted to $42,579.49. Bar and restaurant revenue figures were not available to the parties for this year.

The following is a list of the tenants who rented commercial space in the Hotel Times Square during the period January 6, 1956, through December 31, 1960, and whose rental payments comprise the commercial space revenue of The Times Square Hotel of New York, Inc.:

Barber Shop
Dentist Office
Jewelry Stand
Merchandise Exporters Office
Newsstand
Letter Carriers Association Office
Public Stenographer Office
Theatre Tickets Office
Valet
Luncheonette
Luggage Shop
Signal Electrician Association
Printers Union
Private School

The United Bank Building primarily had two employees, an elevator girl and fireman or so-called janitor who also relieved the elevator girl. The janitor had part-time relief.

In most instances the tenants of the United Bank Building supplied their own furniture and fixtures in the conduct of their business activities in the space rented from the United Bank Building.

There were no transients who used the United Bank Building.

The Hotel Times Square has about 815 guest rooms. It operates a restaurant and bar, and also rents space to a restaurant. The staff at the Hotel Times Square consists of from 130 to 140 employees who operate the hotel and provide the usual service for the guests. The Hotel Times Square has an operating manager whose duties are to supervise the employees, handle transient trade, and purchase food and liquor.

The president and treasurer of The Times Square Hotel of New York, Inc., who holds the same offices in the petitioner, takes care of all purchases, advertising, and the general supervision and planning of the hotel operations.

OPINION

BLACK, Judge: We have but one issue in this proceeding to decide. That issue is whether the sale of the property owned by petitioner in Cincinnati known as the United Bank Building and the reinvestment of the proceeds thereof in the purchase of 80 percent of the capital stock of The Times Square Hotel of New York, Inc., which, after its incorporation acquired and operated the Hotel Times Square in New York City, constituted an involuntary con-

version within the meaning of section 1033 (a) (1) and (3) (A), 1954 Code.[1]

There is no dispute between the parties as to the amount of gain which petitioner received from the sale of its property in Cincinnati as the result of condemnation proceedings. Likewise, there is no dispute that petitioner invested the entire amount of the net proceeds of the sale in the stock of a corporation which was organized for the purpose of acquiring a hotel property in New York City. The fact that the property sold was located in Cincinnati and the property acquired was located in New York City, we think, makes no difference. Respondent does not contend that it does. What respondent does contend is that petitioner's United Bank Building, which it owned in Cincinnati prior to its sale as a result of the condemnation proceedings, was not the same type of property as the Hotel Times Square in New York City, therefore, the proceeds of the sale of the United Bank Building were not converted

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[1] SEC. 1033. INVOLUNTARY CONVERSIONS.

(a) General Rule. — If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(1) Conversion into similar property. — Into property similar or related in service or use to the property so converted, no gain shall be recognized.

• • • •

(3) Conversion into money where disposition occurred after 1950. — Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain. — If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

• • •

into property "similar or related in service or use to the property so converted" as the applicable statute says it must be if the taxpayer is entitled to have the gain non-recognized for tax purposes.

The fact that the net proceeds of the sale of the United Bank Building were invested in the stock of another corporation instead of being used directly in the purchase of a building makes no difference under the applicable statute, if the new corporation acquired a building which was "similar or related in service or use to the property so converted." Thus, the question we have here to decide is whether the Hotel Times Square building in New York City is "similar or related in service or use" to the United Bank Building in Cincinnati.

It is petitioner's contention that the Hotel Times Square building is "similar or related in service or use" to the United Bank Building within the meaning of the applicable statute. Petitioner's contention in this respect is largely based on the fact that both buildings were owned and held for the same purpose, viz, to yield rental income; therefore, says the petitioner the transactions come within the applicable statute. In making this contention petitioner relies heavily on the decision of the Court of Appeals for the Fourth Circuit which reversed the Tax Court in *Steuart Brothers, Inc.*, v. *Commissioner*, 261 F. 2d 580. Our Court, in other cases which we have had since then, has declined to follow the holding of the Fourth Circuit in *Steuart Brothers, Inc.* v. *Commissioner, supra.* In the recent case, *Liant Record, Inc.*, 36 T. C. — (April 28, 1961), we discussed the Fourth Circuit's decision in the *Steuart* case rather fully and after such discussion we said:

> We have again carefully considered this basic question and, with due respect for the opinion of the Court of Appeals for the Fourth Circuit, we believe the

> proper view is that taken by the Court of Appeals for the Third Circuit in the *McCaffrey* case, which accords with the view previously taken by us.

Then we went on to say:

> In view of the foregoing we hold that the respondent did not err in recognizing the gain derived upon the disposition of the property at 1819 Broadway.

In *Liant Records, Inc., supra*, the taxpayers owned an office building in New York City, title to which was taken by the City of New York under condemnation proceedings. The proceeds were used by the taxpayers to buy three apartment buildings in New York City. We held that the apartment buildings were not "property similar or related in service or use to the property so converted" within the meaning of section 1033 of the 1954 Code, and that the taxpayers there were not entitled to the nonrecognition provisions of the statute.

Here, the petitioner owned an office building in Cincinnati and when it was sold as the result of condemnation proceedings it invested the proceeds in a hotel building in the city of New York. As we have already stated, the fact that the two buildings were located in different cities makes no difference nor does it make any difference that the petitioner invested the money in another corporation, acquiring the building in question, if the building so acquired is "similar or related in service or use to the property so converted." But we do not think it can be said that a building used primarily as a hotel is "property similar or related in service or use to the property so converted" in the instant case. And we do not think this situation is changed even though there were in the Hotel Times Square building various storerooms, meeting rooms, and living rooms that are rented to daily, weekly, and monthly tenants. Notwithstanding these facts, the Hotel

Times Square building was used primarily as a hotel building, whereas the United Bank Building in Cincinnati was used primarily as an office building.

In the *Liant Record, Inc.*, case *supra*, we pointed out as follows:

> The properties purchased in replacement thereof consisted of three residential apartment buildings containing a total of 175 apartments, only 11 of which were used by tenants for commercial purposes, although in one of them there were a restaurant, a stationery store, a tailor shop, and a supermarket and one had a valet shop in the basement. * * *

Notwithstanding the foregoing facts, we held that the apartment buildings still remained apartment buildings and that these apartment buildings were not "similar or related in service or use to the property so converted" which, in that case, was an office building.

We hold in the instant case that notwithstanding there are several tenants which similarly correspond to those which were present in the apartment buildings in the *Liant Record* case, it still remained primarily a hotel building used and operated for that purpose mainly, and was not "similar or related in service or use to the property so converted," viz, the United Bank Building in Cincinnati. On this issue we sustain the respondent.

Decision will be entered for the respondent.

Office-Supreme Court, U.S.
FILED
MAY 8 1963
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LIBRARY
SUPREME COURT, U. S.

No. 921

In the Supreme Court of the United States

October Term, 1962

[redacted]

v.

[redacted]

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE [redacted] CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

[redacted]
Attorney General,
[redacted]
Assistant Attorney General,
[redacted]
Special Assistant to the Attorney General,
Department of Justice,
Washington 25, D.C.

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 991

THE CLIFTON INVESTMENT CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. 42–51) are reported at 36 T.C. 569. The opinion of the court of appeals (Pet. 29–34) is reported at 312 F. 2d 719, and the order denying the taxpayer's petition for rehearing *en banc* (Pet. 35) is not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on February 6, 1963 (Pet. 29), and rehearing was denied on March 11, 1963 (Pet. 35). The petition for a writ of certiorari was filed on April 5, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

1. Whether a hotel in New York City, acquired (through the purchase of the controlling stock in a corporation) by the taxpayer with the proceeds from the sale of its office building to the City of Cincinnati under threat of eminent domain, constituted property "similar or related in service or use" to the converted property within the meaning of Section 1033 (a)(3) of the Internal Revenue Code of 1954, so as to entitle the taxpayer to treat the transaction as a tax-free involuntary conversion.

2. Whether the taxpayer is entitled to have its petition for rehearing passed upon by the entire court, rather than merely the panel (composed of one circuit judge and two district judges) which heard and decided the case.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 1033 of the Internal Revenue Code of 1954, Sections 46 and 292 of Title 28 of the United States Code, and Section 1.1033(a)-2 of Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 9–16.

STATEMENT

The taxpayer is a real estate investment corporation. In 1956, under threat of eminent domain, it sold to the City of Cincinnati a six-story office building, known as the United Bank Building, which had been held for the production of rental income from commercial tenants. The proceeds of the sale were used by the taxpayer to purchase eighty per cent of the

outstanding stock of Times Square Hotel of New York, Inc., a corporation which in turn purchased the Hotel Times Square in New York City.[1] (Pet. 29.)

The hotel, like the bank building, was held for the production of rental income. However, whereas the office building required only two employees (a janitor and an elevator operator), a staff of between 130 and 140 employees was needed to operate the hotel and service its guests and commercial tenants. Moreover, in connection with the guest room facilities from which it derived approximately 96 per cent of its income, the hotel provided furniture, linens, and daily personal services of every description. The office building, on the other hand, though some of its tenants had living quarters on the premises, furnished none of the services typically demanded by hotel guests. And whereas space in the office building was rented to commercial tenants of all types, commercial space in the hotel was leased for the most part to tenants whose occupations fitted in with the operation of the hotel and contributed to the service of its guests.[2] (Pet. 32–33.)

In its income tax return for the fiscal year ending November 30, 1956, the taxpayer reported the sale

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[1] The fact that the replacement property was acquired by taxpayer through the purchase of a controlling interest in a corporation owning the property does not in itself disqualify the transaction from nonrecognition treatment. See Section 1033(a)(3)(A) of the Internal Revenue Code of 1954, Appendix, *infra*, p. 9.

[2] The hotel space was occupied, *inter alia*, by a dentist's office, a newsstand, a theater ticket office, a valet, a barbershop, a luggage shop, a public stenographer office, and restaurants. (Pet. 46.)

of the office building as a nontaxable transaction under Section 1033(a) of the Internal Revenue Code of 1954 (Appendix, *infra*, p. 9), maintaining that the hotel which it purchased with the proceeds was "similar or related in service or use" to the property it had been forced to sell, both having been held for rental income. The Commissioner, however, ruled that the gain from the sale of the office building was recognizable, and assessed a deficiency in the amount of $19,057.09. The Tax Court upheld the Commissioner's determination.

The court of appeals, though rejecting the "functional test" employed by the Tax Court, nonetheless affirmed its decision on the ground that the two properties differed so materially in what they demanded of the taxpayer by way of services, management activity, and tenant relations, as to render Section 1033(a) inapplicable.

The taxpayer thereupon filed a petition for rehearing *en banc*. Rehearing was denied by the division of the court which had decided the case, and the taxpayer filed a timely petition for certiorari.

ARGUMENT

1. The taxpayer urges that this Court grant certiorari in order to resolve a conflict among the circuits as to the proper legal test to be used in applying Section 1033(a), Appendix, *infra*, p. 9, to situations in which the taxpayer is not the end user of the property, but merely an investor, *e.g.*, an owner-lessor. That conflict, however, has no bearing upon the disposition of this case. For, as we develop below, the court of appeals expressly rejected the test urged by the govern-

ment and adopted that espoused by the taxpayer—holding, however, that under the circumstances of this case the condemned and replacement properties do not possess the requisite similarity even under the test most favorable to the taxpayer.

In *McCaffrey* v. *Commissioner*, 275 F. 2d 27, certiorari denied, 363 U.S. 828, the Third Circuit, following a long-standing practice of the Tax Court, held that in determining whether properties are "similar or related in service or use" under Section 1033(a), the same criterion should be employed whether the taxpayer holds the property as an investor or uses it in his own trade or business. That test—the so-called "functional test"—involves a comparison of the physical characteristics of the premises and the uses made of them by the actual occupants. However, the Second, Fourth, Seventh, Eighth, and here the Sixth, Circuits have held that the "functional test," repeatedly advocated by the government, is inappropriate where the taxpayer is not himself the occupant. Those courts (except perhaps the Fourth Circuit) have followed the test laid down by the Second Circuit in *Liant Record, Inc.* v. *Commissioner*, 303 F. 2d 326, 329—one which requires a "comparison of the services or uses of the original and replacement properties *to the taxpayer-owner*," and, specifically, a comparison of such factors as "the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of his business risks connected with the properties."[3] In the

[3] The *Liant Record* test was accepted by the Seventh Circuit in *Pohn* v. *Commissioner*, 309 F. 2d 427, and by the Sixth Circuit in the very recent case of *Capitol Motor Car Co.* v.

instant case the government argued for the "functional test", the taxpayer for the *Liant Record* standard. And the Sixth Circuit expressly adopted the latter. It went on to hold, however—correctly, we think—that what the hotel demanded of the taxpayer in the way of management, services, and relations to its tenants varied materially from what was demanded by the office building, so that even in terms of the considerations deemed relevant in *Liant Record*, the taxpayer could not prevail. Thus, the only issue before this Court is whether the *Liant Record* test was correctly applied to the facts of this case. And on that issue, the decision below is plainly not in conflict with the decision of any other court.

Furthermore, the importance of the general problem was greatly reduced by the enactment in 1958 of subsection (g) of Section 1033,[4] which provides that in most cases of involuntary conversion of real prop-

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Commissioner, 314 F. 2d 469, decided adversely to the Commissioner. The Eighth Circuit adopted the Second Circuit's test but added the requirement that there must also be "a reasonable similarity in the leased premises themselves". *Loco Realty Co.* v. *Commissioner*, 306 F. 2d 207, 215. The test earlier enunciated by the Fourth Circuit, *Steuart Brothers* v. *Commissioner*, 261 F. 2d 580, 584, states that the properties must be of "the same general class", and it is likely that if asked to promulgate standards necessary for the application of the test it would adopt those of the Second Circuit, for *Steuart* cites the Tax Court opinion in *Winter Realty & Construction Co.* v. *Commissioner*, 2 T.C. 38, with approval, and it seems apparent that it is from the Second Circuit's consideration of *Winter Realty*, 149 F. 2d 567, 570 (C.A. 2d), that the *Liant Record* test was later ~~denied~~ derived.

[4] The new subsection was added by Section 46(a) of the Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606.

erty, the "similar or related in service or use" requirement will be deemed satisfied if the newly acquired property is of "like kind." Under the "like kind" standard—which has long been the determinant of tax recognition or non-recognition in the case of voluntary exchanges under Section 1031—any replacement of real property by other real property would qualify as a tax-free transaction. True, the amendment does not apply in the situation where, as here, the property taken is replaced by stock representing the control of a corporation which owns the replacement property; but very few of the litigated cases involve this feature.

2. There is no merit to taxpayer's contention that its petition for rehearing, since it was addressed to the court *en banc*, should have been passed upon by the entire court. *Western Pacific Railroad Case*, 345 U.S. 247.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

ROBERT N. ANDERSON,
ARTHUR E. STROUT,
Attorneys.

MAY 1963.

[1] See S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 72–73 (1958–3 Cum. Bull. 922, 993–994).

APPENDIX

Internal Revenue Code of 1954:

SEC. 1033. INVOLUNTARY CONVERSIONS.

(a) *General Rule.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsory or involuntarily converted—

* * * * *

(3) *Conversion into money where disposition occurred after 1950.*—Into money or into property not similar or related in service or use to the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) *Nonrecognition of gain.*—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. * * *

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 1033.)

28 U.S.C.:

SEC. 46. *Assignment of judges; divisions; hearings; quorum*

(a) Circuit judges shall sit on the court and its divisions in such order and at such times as the court directs.

(b) In each circuit the court may authorize the hearing and determination of cases and controversies by separate divisions, each consisting of three judges. Such divisions shall sit at the times and places and hear the cases and controversies assigned as the court directs.

(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit.

(d) A majority of the number of judges authorized to constitute a court or division thereof, as provided in paragraph (c), shall constitute a quorum.

* * * * *

SEC. 292. [as amended by Sec. 3, Act of August 25, 1958, P.L. 85–755, 72 Stat. 848.] *District judges.*

(a) The chief judge of a circuit may designate and assign one or more district judges within the circuit to sit upon the court of appeals or a division thereof whenever the business of that court so requires. Such designations or assignments shall be in conformity with the rules or orders of the court of appeals of the circuit.

(b) The chief judge of a circuit may, in the public interest, designate and assign temporarily any district judge of the circuit to hold a district court in any district within the circuit.

(c) The Chief Justice of the United States may designate and assign temporarily a dis-

trict judge of one circuit for service in another circuit, either in a district court or court of appeals, upon presentation of a certificate of necessity by the chief judge or circuit justice of the circuit wherein the need arises.

(d) The Chief Justice of the United States may designate and assign temporarily any district judge to serve as a judge of the Court of Claims, the Court of Customs and Patent Appeals or the Customs Court upon presentation to him of a certificate of necessity by the chief judge of the court in which the need arises.

Treasury Regulations (1954 Code):

SECTION 1.1033(a)-2. *Involuntary conversion where disposition of the converted property occurred after December 31, 1950.*—(a) *In general.*—This section applies only with respect to involuntary conversions where the disposition of the converted property occurred after December 31, 1950, and where the proceeds are received in a taxable year to which the Internal Revenue Code of 1954 applies. The term "disposition of the converted property" means the destruction, theft, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b) *Conversion into similar property.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such nonrecognition of gain is mandatory.

(c) *Conversion into money or into dissimilar property.*—(1) If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involun-

tarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period specified in subparagraph (3) of this paragraph. For the purposes of section 1033 the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(2) All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement) shall be reported in the return for the taxable year or years in which any of such gain is realized. An election to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph shall be made by including such gain in gross income for such year or years only to such extent. If, at the time of filing such a return, the period within which the converted property must be replaced has expired, or if such an election is not desired, the gain should be included in gross income for such year or years in the regular manner. A failure to so include such gain in gross income in the regular manner shall be deemed to be an election by the taxpayer to have such gain rec-

ognized only to the extent provided in subparagraph (1) of this paragraph even though the details in connection with the conversion are not reported in such return. If, after having made an election under section 1033(a)(3), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such recomputation should be in the form of an "amended return". If a decision is made to make an election under section 1033 (a)(3) after the filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed. If the replacement of the converted property occurs in a year or years in which none of the gain on the conversion is realized, all of the details in connection with such replacement shall be reported in the return for such year or years.

(3) The period referred to in subparagraphs (1) and (2) of this paragraph is the period of time commencing with the date of the disposition of the converted property, or the date of the beginning of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier, and ending one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may be designated pursuant to an application of the taxpayer. Such application shall be made prior to the expiration of the one year after the close of the first taxable year in which any part of the gain from the conversion is realized, and shall contain all of the details

in connection with the involuntary conversion. Such application shall be made to the district director for the internal revenue district in which the return is filed for the first taxable year in which any of the gain from the involuntary conversion is realized. No extension of time shall be granted pursuant to such application unless the taxpayer can show reasonable cause for not being able to replace the converted property within the required period of time.

(4) Property or stock purchased before the disposition of the converted property shall be considered to have been purchased for the purpose of replacing the converted property only if such property or stock is held by the taxpayer on the date of the disposition of the converted property. Property or stock shall be considered to have been purchased only if, but for the provisions of section 1033(c), the unadjusted basis of such property or stock would be its cost to the taxpayer within the meaning of section 1012. If the taxpayer's unadjusted basis of the replacement property would be determined, in the absence of section 1033(c), under any of the exceptions referred to in section 1012, the unadjusted basis of the property would not be its cost within the meaning of section 1012. For example, if property similar or related in service or use to the converted property is acquired by gift and its basis is determined under section 1015, such property will not qualify as a replacement for the converted property.

(5) If a taxpayer makes an election under section 1033(a)(3), any deficiency, for any taxable year in which any part of the gain upon the conversion is realized, which is attributable to such gain may be assessed at any time before the expiration of three years from the date the district director with whom the return for such year has been filed is notified by the taxpayer

of the replacement of the converted property or of an intention not to replace, or of a failure to replace, within the required period, notwithstanding the provisions of section 6212(c) or the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain all of the details in connection with such replacement. Such notification should be made in the return for the taxable year or years in which the replacement occurs, or the intention not to replace is formed, or the period for replacement expires, if this return is filed with such district director. If this return is not filed with such district director, then such notification shall be made to such district director at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such district director before the filing of such return.

(6) If a taxpayer makes an election under section 1033(a)(3) and the replacement property or stock was purchased before the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending before such last taxable year, which is attributable to such election may be assessed at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any law or rule of law which would otherwise prevent such assessment.

(7) If the taxpayer makes an election under section 1033(a)(3), the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the replacement property or stock, regardless of whether such amount is realized in one or more taxable years.

(8) The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

(9) There is no investment in property similar in character and devoted to a similar use if—

(i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(ii) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(iii) The owner of a requisitioned tug uses the proceeds to buy barges.

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